Supreme Court, U.S.
FILED
APR 17 1989
JOSEPH F. SPANIOL, JR.
CLERK

No. 88-1518

In The
Supreme Court of the United States
October Term, 1988

EDWARD C. ABELL, JR. AND CAREY WALTON, Individually And As Representatives Of The Class Of Purchasers Of Westside Habilitation Center Revenue Bonds,

Petitioners,

vs.

WRIGHT, LINDSEY & JENNINGS, VALLEY FORGE INSURANCE COMPANY AND JOE E. FRYAR,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court of Appeals For The Fifth Circuit

BRIEF IN OPPOSITION

GENE W. LAFITTE
Counsel of Record
EDWARD J. GAY, III
LISKOW & LEWIS
One Shell Square, 50th Floor
New Orleans, LA 70139-5001
Telephone: (504) 581-7979

Attorneys for Wright, Lindsey & Jennings, Respondent

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
or call collect (402) 342-2831

24pp

QUESTIONS PRESENTED

1. *Attorney Liability To Non-Clients*

Do attorneys acting *solely* as counsel to the underwriters in a securities offering owe a duty of disclosure to the purchasers of the securities where: (a) the attorneys reviewed *for the underwriters* offering documents that had been prepared by others; (b) the attorneys issued *no* opinion letter as to the adequacy of disclosure in the offering documents; (c) the attorneys did *not* sign the offering documents; (d) the offering documents did *not* indicate that the attorneys approved the adequacy of the offering documents' disclosure; (e) the only mention of the attorneys in the offering documents was the correct statement that the attorneys had "passed on" some unspecified legal issues "for the underwriters"; (f) the attorneys were *not* involved in securities solicitation and strictly limited their activities to traditional legal advice to their clients (the underwriters); and (g) the attorneys had no contact with any of the securities purchasers?

2. *The Lack Of Evidence Of Reliance*

a. In expressing and applying the rule of law specified by this Court in *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 92 S. Ct. 1456 (1972), for presuming reliance in cases involving "primarily" nondisclosure, did the court of appeals, whose opinion carefully reviewed the 97 volume record (including the transcript of the nine week trial), err in concluding that the evidence does *not* show that this case involves *primarily* nondisclosure?

b. In expressing and applying the rule of law specified by this Court in *Basic Inc. v. Levinson*, — U.S. —, 108 S. Ct. 978 (1988), for presuming reliance in the factual context of an "open, well-developed" market for the security involved (the fraud-on-the-market theory), did the court of appeals err in concluding that the evidence does *not* show that the securities involved in this case were traded on an *open, well-developed* market?

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
TABLE OF CONTENTS	iii
TABLE OF AUTHORITIES	iv
STATEMENT OF THE CASE	1
REASONS TO DENY THE WRIT	3
1. The Limited Duty Attorneys Owe to Non-Clients	3
2. The Petitioners' Lack Of Reliance	10
A. The *Affiliated Ute* Presumption	11
B. The Fraud-On-The-Market Theory	13
CONCLUSION	17

TABLE OF AUTHORITIES

Page

CASES:

Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 92 S. Ct. 1456 (1972) 10, 11, 12

Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490 (7th Cir. 1986) 7

Basic Inc. v. Levinson, — U.S. —, 108 S. Ct. 978 (1988) 11, 13, 14

Bonner v. City of Prichard, 661 F.2d 1206 (11th Cir. 1981) (en banc) 16

Cameron v. E.M. Adams & Co., 547 F.2d 473 (9th Cir. 1976) 12

Chiarella v. United States, 445 U.S. 222, 100 S. Ct. 1108 (1980) 6, 7

Cleary v. Perfectune, Inc., 700 F.2d 774 (1st Cir. 1983) 10

Cronin v. Midwestern Oklahoma Development Authority, 619 F.2d 856 (10th Cir. 1980) 5

DCD Programs, Ltd. v. Leighton, 833 F.2d 183 (9th Cir. 1987) 7

Dirks v. S.E.C., 463 U.S. 646, 103 S. Ct. 3255 (1983) 6, 7

Finkel v. Docutel/Olivetti Corp., 817 F.2d 356 (5th Cir. 1987), *cert. denied*, — U.S. —, 108 S. Ct. 1220 (1988) 14

Harris v. Union Electric Co., 787 F.2d 355 (8th Cir.), *cert. denied*, 479 U.S. 823, 107 S. Ct. 94 (1986) 12

In Re Carter, 1981 [CCH] Fed. Sec. L. Rep. ¶82,847, S.E.C. Release No. 34-17597 ..... 8, 9, 10

Investors Research Corp. v. S.E.C., 628 F.2d 168 (D.C. Cir.), *cert. denied*, 449 U.S. 919, 101 S. Ct. 317 (1980) 10

TABLE OF AUTHORITIES—Continued

Page

IIT v. Cornfeld, 619 F.2d 909 (2d Cir. 1980) 10

Keene Corp. v. Weber, 394 F. Supp. 787 (S.D.N.Y. 1975) 4

Metge v. Baehler, 762 F.2d 621 (8th Cir. 1985), *cert. denied sub nom, Metge v. Bankers Trust Co.*, 474 U.S. 1073, 106 S. Ct. 832 (1986) 10

Monsen v. Consolidated Dressed Beef Co., 579 F.2d 793 (3rd Cir.), *cert. denied sub nom, First Pennsylvania Bank N.A. v. Monsen*, 439 U.S. 930, 99 S. Ct. 318 (1978) 10

S.E.C. v. Manor Nursing Centers, Inc., 458 F.2d 1082 (2nd Cir. 1972) 5, 6

S.E.C. v. Seaboard Corp., 677 F.2d 1301 (9th Cir. 1982) 10

S.E.C. v. Spectrum, Ltd., 489 F.2d 535 (2nd Cir. 1973) 4

S.E.C. v. Washington County Utility Dist., 676 F.2d 218 (6th Cir. 1982) 10

Sanders v. John Nuveen & Co., 619 F.2d 1222 (7th Cir. 1980), *cert. denied*, 450 U.S. 1005, 101 S. Ct. 1719 (1981) 16

Schneberger v. Wheeler, 859 F.2d 1477 (11th Cir. 1988) 10

Seattle-First Nat'l Bank v. Carlstedt, 800 F.2d 1008 (10th Cir. 1986) 10

Sharp v. Coopers & Lybrand, 649 F.2d 175 (3rd Cir. 1981), *cert. denied*, 455 U.S. 938, 102 S. Ct. 1427 (1982) 12

Shores v. Sklar, 647 F.2d 462 (5th Cir. 1981) (en banc), *cert. denied*, 459 U.S. 1102, 103 S. Ct. 722 (1983) 14, 15, 16

Woodward v. Metro Bank of Dallas, 522 F.2d 84 (5th Cir. 1975) 10

TABLE OF AUTHORITIES—Continued

Page

STATUTES:

Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 771(2) 16

MISCELLANEOUS:

L. Loss, *Fundamentals of Securities Regulation* 889 (2d ed. 1988) 16

S.E.C. Release No. 34-17831, 1981 [CCH] Fed. Sec. L. Rep. ¶ 82,874 (June, 1981) 9

STATEMENT OF THE CASE

Respondent, the law firm of Wright, Lindsey and Jennings ("WLJ"), served solely as underwriters' counsel for the Westside bond offering. WLJ had no attorney-client relationship with the bond purchasers or with any party connected with the bond offering other than the underwriters. Three weeks before the scheduled date for the bond offering, and eight weeks before the actual date of the bond offering, WLJ was engaged as counsel for the underwriters. At that time, the offering documents had already been drafted. WLJ's connection with the offering documents was limited to reviewing them in preliminary and final form for the underwriters and counseling the underwriters regarding a few revisions. Trial Trans. v. 62 at 145-46; v. 81 at 18, 19, 20, 70-71, 109-112; v. 82 at 8-11.

The offering documents, a summary and preliminary and final versions of an "Official Statement", constitute very lengthy and detailed representations about the bond offering and the issuer (Westside). WLJ did not issue an opinion letter as to the adequacy of disclosure in the offering documents. (Other attorneys, the bond counsel, did issue an opinion letter and it was attached as an exhibit to the offering documents.) WLJ did not sign the offering documents. Nothing in the offering documents indicated that WLJ in any way approved the adequacy of the offering documents' disclosure. The only mention of WLJ

in the offering documents is the correct statement that WLJ had "passed on" some unspecified legal issues "for the underwriters." Trial Exhibits P-111, P-114 and P-290.

There was no evidence that any of the unnamed class members had ever read, seen, or even requested copies of the offering documents. Indeed, the two named class representatives admitted that neither had ever read, seen, or requested copies of the offering documents.

WLJ was never involved in any bond sales solicitation or promotion. There is no evidence that WLJ ever had any contact with any of the bond purchasers. As the record reflects, and the court of appeals' opinion makes clear, WLJ's role in the bond offering was limited to providing traditional legal counsel to its clients—the underwriters.

The bonds were issued by Westside as an initial public offering. Westside was a start-up enterprise which had not previously issued any bonds or other securities. The bonds were never listed on the New York or American Stock Exchange or any other organized exchange. The bonds were traded by some brokers on a sporadic basis after the initial public offering.

The Westside bonds were issued in April 1982 and some of the proceeds were deposited with the Penn Square National Bank which failed in July 1982. That bank failure

resulted in considerable construction delays on the Westside facility. After construction was completed, Westside began accepting patients, was quickly filled to capacity, and at the time of trial continued to have a full complement of patients and a waiting list.

After two and a half years of full payments on the bonds, there was a partial default in October, 1984. Westside filed for reorganization on March 22, 1985. Westside's plan of reorganization was confirmed prior to April 1986, and, beginning in April 1986, Westside resumed payments on the bonds but at a lower interest rate.

REASONS TO DENY THE WRIT

1. The Limited Duty Attorneys Owe to Non-Clients.

WLJ was engaged by the underwriters and owed its duties of care and loyalty to the underwriters. The petitioners, the bond purchasers, were never WLJ's clients and WLJ never assumed any duty to the petitioners. The petitioners argue to this Court, as they did to the court of appeals, that merely by serving as counsel to the underwriters, WLJ assumed a duty *to the bond purchasers* (not just the underwriters) of insuring adequate disclosure in the offering documents. The court of appeals dealt squarely with that argument and rejected it on the basis of well-settled principles of attorney liability, attorney-client relations, and attorney-client confidentiality and privilege.

> We cannot agree with the bondholders' argument. Traditionally, lawyers are accountable only to their clients

> for the sufficiency of their legal opinions. It is well understood in the legal community that any significant increase in attorney liability to third parties could have a dramatic effect upon our entire system of legal ethics. An attorney required by law to disclose "material facts" to third parties might thus breach his or her duty, required by good ethical standards, to keep attorney-client confidences. Similarly, an attorney required to declare publicly his or her legal opinion of a client's actions and statements may find it impossible to remain as loyal to the client as legal ethics properly require.
>
> Cognizant of these risks, the law, as a general rule, only rarely allows third parties to maintain a cause of action against lawyers for the sufficiency of their legal opinions. In general, the law recognizes such suits only if the non-client plaintiff can prove that the attorney prepared specific legal documents that represent explicitly the legal opinion of the attorney preparing them, for the benefit of the plaintiff.
>
> In practice, this rule has meant that an attorney is rarely liable to any third party for his or her legal work unless the attorney has prepared a signed "opinion" letter designed for the use of a third party. *Compare S.E.C. v. Spectrum, Ltd.*, 489 F.2d 535 (2nd Cir. 1973) (plaintiff may state rule 10b-5 action against attorney who signed an opinion letter another had declined to sign) *with Keene Corp. v. Weber*, 394 F. Supp. 787 (S.D.N.Y. 1975) (attorney not liable under rule 10b-5 because no misleading opinion letter at issue).

Appendix To Petition at 41-44 (most citations and all footnotes omitted). Thus, the court of appeals declined to undertake a radical departure from accepted principles so as to impose duties upon attorneys in securities transactions that would be entirely different from and inconsistent with the duties of attorneys in every other type of transaction.

The petitioners assert that the court of appeals' decision is in conflict with decisions from three other circuits. Petition at 9-10. However, those three decisions not only are distinguishable on their facts from the present case, they are perfectly consistent with the court of appeals' decision in this case.

Cronin v. Midwestern Oklahoma Development Authority, 619 F.2d 856 (10th Cir. 1980) was simply a reversal of a summary judgment for the defendants because the district court had allowed almost no time for discovery prior to granting summary judgment. 619 F.2d at 862-63 ("The main thrust of . . . this opinion is that discovery was prematurely cut short."). Further, the court of appeals in the present case distinguished *Cronin* on the ground that the defendant attorneys in *Cronin* were bond counsel rather than underwriters' counsel. "In *Cronin*, the Tenth Circuit suggested that courts could impose rule 10b-5 liability upon bond counsel, who ordinarily does issue an opinion letter that comes attached to the offering statement or prospectus." Appendix To Petition at 44. In fact, in the present case, the bond counsel, attorneys entirely separate frm WLJ, did issue an opinion letter which was attached as an exhibit to the offering documents. Trial Exhibits P-114, P-290. The bond counsel settled prior to trial.

In *S.E.C. v. Manor Nursing Centers, Inc.,* 458 F.2d 1082 (2nd Cir. 1972), the facts were radically different frm those of the present case in every material respect. The defendant attorney in *Manor* personally engaged in securities sales solicitation, *Id.* at 1090, had actual knowledge of wrongful conduct prior to the closing, *Id.* at 1090-

92, made a personal profit of at least $125,000 by selling some of his stock, *Id.* at 1094, made stock sales by agreeing to cause a corporation he controlled to repurchase stock, which agreement was not revealed in the prospectus, *Id.* at 1091, purchased some of the stock himself through a corporation he controlled to conceal that not all of the offering had actually been sold in violation of the "all or nothing" provision of the prospectus, *Id.* at 1091, accepted stock in lieu of his legal fee in violation of the prospectus' provision that all stock would be sold for cash, *Id.* at 1091, gave purchasers personal guarantees that they would make a certain profit on their investment, *Id.* at 1093, and served as the promoter's and issuer's counsel rather than the underwriter's counsel, *Id.* at 1089. Thus, the attorney in *Manor* functioned as a salesman, promoter, and investment counselor to securities purchasers, and personally undertook actions in violation of the terms of the prospectus and designed to conceal violations of the terms of the prospectus. Consequently, the attorney defendant in *Manor,* having dealt with the securities purchasers, had a duty to them to avoid misrepresentations. In contrast, WLJ engaged in no bond solicitation, promotion or other contact with bond purchasers and limited its activities strictly to providing traditional legal counsel to the underwriters.[1]

---

[1] Also, *Manor* was an SEC enforcement action for an injunction rather than a private action for damages. Thus, so long as the defendant attorney in *Manor* breached a duty to *some* party, the issue of whether the attorney defendant owed a duty to a *particular* party simply did not arise. *See Dirks v. S.E.C.*, 463 U.S. 646, 103 S. Ct. 3255 (1983); *Chiarella v. United States*, 445 U.S. 222, 100 S. Ct. 1108 (1980).

DCD Programs, Ltd. v. Leighton, 833 F.2d 183 (9th Cir. 1987), involved a suit by clients against attorneys who had issued opinion letters to those clients. Thus, *DCD Programs* is entirely different from the present case in that it rested on the undisputed duty of an attorney to his or her own client. "[B]y virtue of appellants' status as clients of [the defendant attorneys], [the defendant attorneys] assumed a fiduciary duty to the appellants." 833 F.2d at 190. Also, in *DCD Programs*, the defendant attorneys were being sued by their clients for wrongful opinion letters issued to the clients. In contrast, the petitioners in the present case were not clients of WLJ and WLJ issued no opinion letter.[2]

The petition cites and quotes testimony by a WLJ attorney and the petitioners' own expert witness to the effect that, as a factual matter, WLJ had a duty to the petitioners even though the petitioners were not clients of WLJ

---

[2] The petitioners cite a number of district court opinions, Petition at 10 nn. 13, 14, most of which the court of appeals readily distinguished, Appendix To Petition at 44 and n. 21, and none of which is apposite to the present case. *Morgan* involved an attorney's opinion letter. *Flight Transportation* involved an attorney who had signed a prospectus. *Schaps* involved an attorney who wrote a letter about his client to the plaintiff. *Seidell* simply does not hold as to whether or not an attorney owes a duty to the public. The reasoning of *North American Acceptance* is circular in that the district court held that the defendant attorneys had "a duty to the buying public not to violate rule 10b-5" without regard to the law that the duty to disclose in the first place "does not come from § 10(b) or rule 10b-5" and "must come from a fiduciary relation outside securities law." *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495-96 (7th Cir. 1986); *see Chiarella v. United States*, 455 U.S. 222, 231-32, 100 S. Ct. 1108, 1116-17 (1980); *Dirks v. S.E.C.*, 463 U.S. 646, 658-59, 103 S. Ct. 3255, 3263-64 (1983).

and WLJ issued no opinion letter. Petition at 11. If this is actually an issue of fact, then it is an issue peculiar to the present case on which the court of appeals found against the petitioner and it is not worthy of review by this Court. In its lengthy opinion, the court of appeals thoroughly reviewed the ninety-seven volume record including the transcript of the nine week trial, and concluded that the petitioners "proved only that WLJ had a duty *to its clients* to ensure that they complied with securities laws." Appendix To Petition at 45 (emphasis added). If, instead, the issue of the underwriters' counsel's duty to non-clients is one of law, rather than fact, then the testimony cited by the petitioners is irrelevant.[3]

The petitioners distort the position of the SEC as to the duty of attorneys to non-clients in securities transactions by a very limited and selective quotation from the SEC's decision *In Re Carter*, 1981 [CCH] Fed. Sec. L. Rep. ¶ 82,847, S.E.C. Release No. 34-17597. Petition at 13.

---

[3] It is noteworthy that the petitioners' quotation of the record is highly selective. The petitioners quote two questions to and answers of a WLJ attorney as if they were related or immediately followed one another when, in fact, the first question and answer is separated from the second question and answer by 126 pages of transcript. Although the WLJ attorney conceded that the purpose of disclosure is to benefit the bond purchasers, he did *not* agree that the duty of underwriters' counsel to review the disclosure was owed to anyone other than the client—the underwriters.

Also, the testimony of the petitioners' expert witness included a qualification limiting its applicability to underwriters' counsel to whatever unspecified extent underwriters' counsel have a duty to "the public" and that qualification, of course, begs the very question raised by the petitioners. Further, the petitioners' expert witness conceded that the underwriters' counsel performs its duties "on behalf of the underwriters". Petition at 11 n. 15.

In that decision, in text not quoted by the petitioners, the SEC clarified that:

> Recognition of the public implications of the securities professional's role does not mean that the Commission has, by rule, imposed duties to the public on lawyers where such duties would not otherwise exist. Accountants, of course, issue audit reports that speak directly to the investing public. . . . But the traditional role of the lawyer as counselor is to advise his client, not the public, about the law.

In Re Carter at 84,150.[4]

The petitioners state that WLJ "participated in preparing the offering documents, approved them and affixed its name to them, with the expectation that the investing public would rely on its actions." Petition at 12. As shown by the Statement Of The Case above, WLJ's involvement was far more limited. The offering documents had been prepared prior to WLJ's engagement. WLJ simply reviewed the offering documents in summary, preliminary and final form for the underwriters. Trial Trans. v. 62 at 145-46; v. 81 at 18, 19, 20, 70-71, 109-112; v. 82 at 8-11. WLJ did not "affix" its name to the offering documents by signing them or otherwise indicating its approval of their adequacy. The only mention of WLJ in the offering documents was the correct statement that WLJ had "passed on" some unspecified legal issues "for the underwriters". Trial Exhibits P-111, P-114 and P-290. WLJ expected that its clients, the underwriters, not "the public", would rely on WLJ.

---

[4] The petitioners also cite SEC Release No. 34-17831, 1981 [CCH] Fed. Sec. L. Rep. ¶ 82,874 (June 1981). Petition at 9. However, that release deals solely with the obligations of attorneys in issuing opinion letters for securities transactions.

The petitioners incorrectly suggest that the court of appeals applied a rule of law to the element of scienter for aiding and abetting liability that is in conflict with the position of the Ninth Circuit. Petition at 13-14. In fact, the court of appeals simply followed its longstanding principles as to Rule 10b-5 aiding and abetting liability as set forth in *Woodward v. Metro Bank of Dallas*, 522 F.2d 84 (5th Cir. 1975). Appendix To Petition at 47-49. The Ninth Circuit decision cited by the petitioners, *S.E.C. v. Seaboard Corp.*, 677 F.2d 1301 (9th Cir. 1982), actually *cites* and *follows* the *Woodward* decision. 677 F.2d at 1311, 1312.[5] Thus, there is no conflict in the circuits as to the element of scienter for Rule 10b-5 aiding and abetting liability.[6]

2. The Petitioners' Lack Of Reliance

The court of appeals followed this Court's ruling in *Affiliated Ute* regarding a presumption of reliance in

---

[5] Also, *Seaboard* involved accountant defendants and not attorney defendants. As noted by the SEC, accountants and attorneys have very different duties with respect to the public in securities transactions. *In Re Carter*, 1981 [CCH] Fed. Sec. L. Rep. ¶ 82,847 at 84,150, S.E.C. Release No. 34-17597 (quoted above).

[6] Other circuits also cite and follow *Woodward* as to Rule 10b-5 aiding and abetting liability. *See Metge v. Baehler*, 762 F.2d 621, 625 (8th Cir. 1985), *cert. denied sub nom, Metge v. Bankers Trust Co.*, 474 U.S. 1073, 106 S. Ct. 832 (1986); *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 778 (1st Cir. 1983); *Schneberger v. Wheeler*, 859 F.2d 1477, 1480 (11th Cir. 1988); *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 799-800, 803 (3rd Cir.), *cert. denied sub nom, First Pennsylvania Bank N.A. v. Monsen*, 439 U.S. 930, 99 S. Ct. 318 (1978); *Seattle-First Nat'l Bank v. Carlstedt*, 800 F.2d 1008, 1011 (10th Cir. 1986); *IIT v. Cornfeld*, 619 F.2d 909, 925-27 (2d Cir. 1980); *S.E.C. v. Washington County Utility Dist.*, 676 F.2d 218, 225 (6th Cir. 1982); *see also Investors Research Corp v. S.E.C.*, 628 F.2d 168, 177-78 (D.C. Cir.), *cert. denied*, 449 U.S. 919, 101 S. Ct. 317 (1980) (action under Section 17(e) of the Investment Company Act).

cases involving primarily nondisclosure. The court of appeals also followed this Court's decision in *Basic Inc.* providing for a presumption of reliance in cases of an "open, well-developed market" for the securities involved (the fraud-on-the-market theory). The court of appeals simply did not find from the evidence in the record that this is factually the type of case in which *Affiliated Ute* or *Basic Inc.* establishes a presumption of reliance.

In reality, the petitioners' complaint is not with the rule of law applied by the court of appeals, but rather, with the court of appeals' review and analysis of the record. The real issues as to reliance, being fact-specific, are peculiar to the present case.

A. The Affiliated Ute Presumption

The petitioners grossly distort the court of appeal's statement and application of the rule of law established in *Affiliated Ute.* The petitioners repeatedly assert that the court of appeals limited the *Affiliated Ute* presumption to cases involving "pure omissions" or "*pure* nondisclosures" (emphasis in original) or "a pure case of nondisclosure". Petition at 15, 17. The court of appeals said nothing of the kind, but to the contrary, said that the *Affiliated Ute* presumption applies in cases involving *primarily* omissions or nondisclosure rather than misrepresentations. "[T]he *Ute* presumption attaches only to those rule 10b-5 actions based *primarily* upon omissions rather than misrepresentations." Appendix To Petition at 28 (emphasis added).

> Our cases indicate that the *Ute* presumption is limited to cases, like *Ute* itself, in which the plaintiffs have based their complaint *primarily* upon alleged omissions. Such non-disclosure suits are those in

> which the complaint is grounded *primarily* in allegations that the defendant has failed to disclose any information whatsoever relating to material facts about which the defendant has a duty to the plaintiff to disclose.

Appendix To Petition at 29 (emphasis added). Thus, the court of appeals' decision precisely follows this Court's *Affiliated Ute* decision creating a presumption of reliance in cases involving "primarily" nondisclosure. "Under the circumstances of this case, involving *primarily* a failure to disclose, positive proof of reliance is not a prerequisite to recovery." *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 153, 92 S. Ct. 1456, 1472 (1972) (emphasis added). The petitioners' actual complaint is with the court of appeals' factual conclusion that the evidence shows that this is not a case involving primarily nondisclosure.[7]

---

[7] Once the court of appeals' decision in this case is read correctly—i.e. that the *Affiliated Ute* presumption applies to cases involving primarily nondisclosure and is not limited to cases involving pure nondisclosure—there is no conflict between the court of appeals' decision and the decisions of the Eighth, Ninth, and Third Circuits cited by the Petition at 17-18. *Harris v. Union Electric Co.*, 787 F.2d 355 (8th Cir.), *cert. denied*, 479 U.S. 823, 107 S. Ct. 94 (1986), expressly holds, just as does the court of appeals in the present case, that the *Affiliated Ute* presumption applies to cases that involve "primarily a failure to disclose". 787 F.2d at 366. Similarly, *Cameron v. E.M. Adams & Co.*, 547 F.2d 473 (9th Cir. 1976), expressly holds, just as does the court of appeals in the present case, that the *Affiliated Ute* presumption will apply to cases involving "primarily [the] defendants withholding relevant information". 546 F.2d at 477. *Sharp v. Coopers & Lybrand*, 649 F.2d 175 (3rd Cir. 1981), *cert. denied*, 455 U.S. 938, 102 S. Ct. 1427 (1982), also cited by the petitioners, simply does not take a position as to whether *Affiliated Ute* applies to cases involving "primarily" nondisclosure as opposed to "pure" nondisclosure and, therefore, is not on point. It does, however, cite and follow *Affiliated Ute*.

B. The Fraud-On-The-Market Theory

The petitioners argue that the court of appeals' conclusion that the fraud-on-the-market theory is not applicable to the facts of the present case, conflicts with this Court's decision in *Basic Inc. v. Levinson*, — U.S. —, 108 S. Ct. 978 (1988), and decisions of other circuits. However, in order to raise this purported conflict, the petitioners misstate the actual holding of the court of appeals. When properly read, the court of appeals' decision conflicts neither with *Basic Inc.* nor the decisions of other circuits.

Basic Inc. involved misrepresentations regarding merger discussions about a company whose stock was traded on a national exchange. Thus, *Basic Inc.* involved purely secondary transactions on a highly organized and extremely efficient national market. Because of an "open, well-developed market", this Court found that it was appropriate to apply a fraud-on-the-market theory based on the presumption that the misrepresentations affected the market price of the stock on the national exchange in a determinable way and amount.

In contrast to *Basic Inc.*, the present case involves misrepresentations in the offering documents for a start-up enterprise's initial public offering of bonds that have never been listed or traded on any exchange. The court of appeals carefully reviewed the voluminous record of the nine week trial and concluded that there was no evidence of an "open, well-developed" market as was present in *Basic Inc.* The court of appeals acknowledged that "a small secondary market, exploited by brokers, developed for the bonds" but that the bonds "were not actively traded on

any exchange or in any large secondary market." Appendix To Petition at 34. Thus, the court of appeals' decision is not inconsistent with *Basic Inc.*, but simply reaches a factual conclusion based upon the record which is, of course, peculiar to the present case and very different from that in *Basic Inc.*

The court of appeals' only other holding with regard to the fraud-on-the-market theory was to limit one of its own decisions in a way that has not yet been considered either by this Court or any other circuit. Even prior to *Basic Inc.*, the court of appeals not only adopted the fraud-on-the-market theory, but formulated a rule by which it could be applied, in very limited circumstances, to an initial public offering for which there was not an open, well-developed market. *See Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981) (en banc), *cert. denied*, 459 U.S. 1102, 103 S. Ct. 722 (1983); *see also Finkel v. Docutel/Olivetti Corp.*, 817 F.2d 356 (5th Cir. 1987), *cert. denied*, — U.S. —, 108 S. Ct. 1220 (1988) (discussing *Shores*).

The court of appeals' *Shores* rule is that, when a securities offering is so fraudulent that the securities are not entitled to be marketed at *any* price, then reliance can be presumed The *Shores* rule rests on the proposition that the mere presence of the securities on the market, while not constituting a representation as to their proper price, implies a representation to the market as a whole that the enterprise issuing securities has *some* worth and the public offering is not wholly fraudulent. *Id.*

In *Shores*, an initial public offering of bonds was made, as in the present case, but the bond offering was wholly fraudulent because there was never any intention or expectation that the issuing enterprise would ever make

a profit and pay any return on the bonds. Thus, the bond purchasers received only the very small amount that could be recovered by sale of the fixed assets of the issuer—the scrap value of the enterprise. In contrast, in the present case, the issuer (Westside) opened, filled to capacity and accumulated a waiting list (which situation continued to exist at the time of trial), made full payments on the bonds without any default for two and a half years, and (after reorganization) resumed payments at over half of the original interest rate. Consequently, the court of appeals correctly concluded that the Westside enterprise always had some legitimate worth and that the *Shores* rule is not applicable. (The jury found that the bond purchasers had out-of-pocket losses of zero. Rec. v. 53 at 7320.) Thus, the court of appeals limited its *Shores* rule of presuming reliance (in the absence of an open, well-developed market) to situations in which the issuer enterprise does not have legitimate worth.

This Court has never considered the *Shores* rule at all, much less the limitation placed upon it in the present case. Thus, the court of appeals' decision in the present case to limit its own *Shores* rule cannot possibly be in conflict with any decision of this Court. And while decisions from other circuits, including those cited by the petitioners, have followed *Shores*, those other circuits have not yet had the opportunity to consider the limitation on *Shores* which the court of appeals applied in the present case. Thus, there is no conflict among the circuits as to the

court of appeals' decision in the present case to limit the application of the *Shores* presumption.[8]

Lastly, the petitioners complain that the court of appeals' decision limiting its own *Shores* rule, imposes "an insurmountable burden upon a plaintiff class in an action involving an initial public offering" and "destroys the effectiveness of the class action device" for an initial public offering. Petition at 21, 22. However, Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 771(2), applies to initial public offerings and grants express remedies to securities purchasers for fraud or negligent misrepresentation. Section 12(2) does not require securities purchasers to prove reliance upon the alleged misrepresentations. *Sanders v. John Nuveen & Co.*, 619 F.2d 1222, 1225 (7th Cir. 1980), *cert. denied*, 450 U.S. 1005, 101 S. Ct. 1719 (1981); L. Loss, *Fundamentals of Securities Regulation* 889 (2d ed. 1988). Thus, a plaintiff class of securities purchasers can be certified for an action based upon Section 12(2) without regard to either proof or presumption of reliance. The court of appeals' limitation of *Shores* in the present case affects only Rule 10b-5 actions. Further, even with the limitation to *Shores* applied by the court of appeals in the present case, Rule 10b-5 class actions can be brought and certified in cases of egregious fraud.

---

[8] A number of the cases cited by the petitioners are Eleventh Circuit decisions. The Eleventh Circuit did not independently adopt *Shores*, but simply adopted it along with all of the other Fifth Circuit precedents when the Eleventh Circuit was created. *See Bonner v. City of Prichard*, 661 F.2d 1206 (11th Cir. 1981) (en banc).

CONCLUSION

The petition for certiorari misstates the record, the court of appeals' decision in the present case, and the decisions of other circuits, in an effort to create the impression that the court of appeals' decision in the present case conflicts with decisions of this Court and/or decisions of other circuits. In fact, the court of appeals' decision in the present case is consistent with well settled law based upon the decisions of this Court, the other circuits, and other courts. The petition for certiorari should be denied.

Respectfully submitted,

GENE W. LAFITTE
Counsel of Record
EDWARD J. GAY, III
LISKOW & LEWIS
One Shell Square, 50th Floor
New Orlean, LA 70139-5001
Telephone: (504) 581-7979

Attorneys for Wright, Lindsey & Jennings, Respondent